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TAGS: ECON EFIN ETRD EINV AR
SUBJECT: ARGENTINA: GOA STRUGGLES TO RESPOND TO
INTERNATIONAL FINANCIAL CRISIS

REF: A. BUENOS AIRES 1320
¶B. BUENOS AIRES 1312
¶C. BUENOS AIRES 1286
¶D. BUENOS AIRES 1160
¶E. BUENOS AIRES 1116
¶F. BUENOS AIRES 790 AND PRIOR

Classified By: Amb. E.A. Wayne. Reasons 1.4 (B,D)

Summary

¶1. (SBU) A "Coordinating Table" chaired by Chief of Cabinet Sergio Massa and including senior Economy Ministry, Central Bank, and financial sector regulatory officials is to meet today, October 7, to organize GoA-wide management of currency, trade, budget, and debt policies in response to the international financial crisis. The most visible GoA reaction to date to the crisis has been a roughly 5% devaluation of the Peso since September 1 to 3.19, a drop that Political Economy Secretary Martin Abeles calls a defined GoA policy to ensure the peso does not lose competitiveness in relation to trading partner currencies, especially the Brazilian Real, which has dropped almost 22% against the US dollar and 17% against the Argentine Peso in recent weeks. With a different emphasis, Central Bank President Martin Redrado, in public comments on October 7, highlighted the GoA's managed currency float as a key element of an "integrated" GoA stabilization strategy that has allowed for a moderate Peso devaluation while currency values in "neighboring countries" (read Brazil) have weakened considerably more in recent weeks.

¶2. (C) Beyond the devaluation, Industries Secretary Fernando Fraguio has been tasked to review current GoA WTO tariff bindings to determine whether adjustments can/should be made to protect domestic industries that could be threatened by a depreciated Real. Faced with declining commodity prices and export tariff revenues, the GoA will continue to approve public utility rate adjustments to limit the budget drain of GoA energy and transportation sector subsidies. The GoA will also selectively slow or defer non-politically sensitive capital infrastructure projects to maintain the primary fiscal surplus in the 3.3 - 3.4% range. On inflation, Chief of Cabinet Sergio Massa (protect), told Ambassador that his initiative to launch a round of meetings of business leaders with INDEC authorities to discuss CPI methodologies is part of an effort to restore the credibility of official inflation data and wrest control of INDEC from Internal Commerce Secretary Guillermo Moreno. Finally, the GoA will press ahead on the "re-financing" of bond holdout debt and guaranteed loans in order to bring in new cash to finance 2009 debt maturities. GoA efforts to ensure pragmatic,

albeit protectionist, economic policy flexibility have been welcomed by local economists amid current market uncertainties. These CFK administration initiatives deepen and expand on a number of ad hoc budget and debt policy reforms initiated over the past three months. End Summary.

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Global Crisis Prompts GoA to Deepen Earlier Reforms
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¶3. (SBU) Over the three months period from July) September 2008, the GoA began to adopt selective "orthodox" budget and macroeconomic reform measures to confront growing market concerns and country risk premiums associated with a squeeze on the primary fiscal surplus (BsAs 1260) and looming sovereign debt maturity concentrations (BsAs 1286). These measures included limited electricity and transportation tariff increases designed to staunch the budget drain of GoA subsidies. They also included surprise GoA announcements that, almost seven years after the nation's December 2001 economic crisis and default, Argentina will pay down its Paris Club arrears (BsAs 1312) and that, almost three years after the GoA,s December 2005 take-it-or-leave-it debt restructuring, Argentine will consider bank offers to deal with bond holdouts (BsAs 1320).

¶4. (SBU) Market responses to these earlier GoA measures were less enthusiastic than the CFK administration had hoped for. Reasons included economists' concerns that tariff hikes were insufficient to control burgeoning subsidies; concern at President Cristina Fernandez de Kirchner's (CFK's) continued support of embattled Argentine statistics agency INDEC; further declines in global agricultural commodity prices (at $338/ton as of October 6, soy prices are now down roughly 45% from their July high of $600/ton); and the downgrade of Argentine risk by Standard & Poor's and Moody's. Over the past week, embassy contacts and local media are reporting that the CFK administration, increasingly concerned over potential contagion and fallout of the international financial crisis, is now moving to substantially deepen and expand on these earlier budget and debt policy reforms.

Coordinated GoA Response to Global Crisis

¶5. (SBU) Economy Ministry Secretary for Political Economy Martin Abeles confirmed to EconCouns October 6 that, on October 3, CFK instructed Chief of Cabinet Sergio Massa to launch a "Coordinating Table" to monitor the international financial crisis, impact on Argentine currency and on equities and debt markets, as well as to ensure a unified GoA regulatory and fiscal policy response. This Table is scheduled to hold its first meeting today, October 7. According to Abeles, CFK and her husband Nestor Kirchner are particularly concerned by the impact of the crisis on the economies of major trading partners, including Brazil, and recent tendencies among these trading partners towards "beggar-thy-neighbor" currency devaluations that could imperil the competitiveness of Argentine industry. In October 7 comments to an American Chamber of Commerce conference, Central Bank President Martin Redrado also noted critically an emerging market legacy of beggar-thy-neighbor policies.

¶6. (SBU) The Coordinating Table is to meet regularly until global market conditions stabilize. In addition to Massa, members include Minister of Economy Carlos Fernandez, Secretary of Finance Hernan Lorenzino, Secretary of the Treasury Juan Carlos Pezoa, BCRA President Martin Redrado, Director of Argentina,s tax and customs authority (AFIP) Claudio Moroni, National Bank President Mercedes Marco del Pont, Director of GoA Social Security entity (ANSES) Amado Boudou, head of the National Securities Commission (CNV) Eduardo Hecker, Superintendent of private pension funds (SAFJP) Carlos Weitz and Superintendent of Insurance (SSN) Miguel Angel Baelo.

Specific GoA Response

¶7. (SBU) According to Secretary Abeles, the GoA's response to international market volatility and recession will focus on the coordinated management of currency value, trade policy, budget adjustment and debt policy:

¶8. (SBU) Managed Peso Devaluation: After trading in the 3.10 to 3.18 range since the beginning of the sub-prime crisis in July 2007, in early July 2008 the Argentine central bank moved to appreciate the peso via reserve sales and futures market intervention to a high of 3.01 in order to stem speculative pressures. Since September 1, however, the central bank has allowed the peso to depreciate back to 3.21, a roughly 5% drop from its 2008 peak. Abeles confirmed that this is a defined GoA policy to ensure that the peso does not "unduly lose competitiveness" in relation to other trading currencies, especially versus the Brazilian real which has dropped 18% against the dollar and almost 14% against the peso since September 1. (Before this drop, the Brazilian real had appreciated roughly 60% against the Argentine Peso since July 2003.)

¶9. (SBU) Separately and with a focus on stability rather than competitiveness, in October 7 remarks to the American Chamber of Commerce, Central Bank President Martin Redrado highlighted Argentina's managed currency float and limited devaluation as a key element of an "integrated" GoA approach to coping with current global financial and equity market volatility. He called this managed float "the only possible scheme for a country like Argentina with a history of macroeconomic volatility" that has allowed Argentina to maintain relative currency stability at the same time currency values in "neighboring countries" (read Brazil and Mexico) have fluctuated 40% in just the past few days.

¶10. (C) Argentina's 5% devaluation vis the US Dollar comes despite recent statements by CFK to the powerful Argentine Industrial Union on the need to maintain a strong peso as an anti-inflationary anchor. Abeles argued that CFK's strong peso comments were less geared to inflation orthodoxy and more to reminding Argentine industrialists that their persistent calls for a weaker peso to maintain competitiveness conflicts with their equally insistent demands for the GoA to reign in domestic inflation that independent analysts currently peg at the 18% level. Separately, Chief of Cabinet Sergio Massa (protect), in an October 6 conversation with Ambassador, noted that his initiative to launch a round of meetings of business leaders with INDEC authorities to discuss CPI methodologies is part of an effort to restore the credibility of official inflation data and wrest control of INDEC from "others" (read Internal Commerce Secretary Guillermo Moreno). He apparently hopes that the organized debates, which will include employers and union economists, will expose flaws in INDEC's system and make fixes easier. Embassy contacts argue that, to boost the credibility of INDEC's CPI index, the GoA should not only discuss methodology, but also reassure the market about the quality and accuracy of the sample data that feeds the index.

¶11. (SBU) Trade Policy Management: The GoA has long used non-tariff barriers to limit the rate of growth of imports from China (BsAs 790) and from Mercosur partner Brazil (BsAs 1116). Abeles confirmed that Economy Ministry Industries Secretary Fernando Fraguio has been tasked to review current GoA WTO tariff bindings to determine whether adjustments can/should be made to protect domestic industries that could be threatened by a depreciated Real making Brazilian exports more competitive in Argentine markets. (Brazil is Argentina's top trading partner; Argentina has run a 65-month old bilateral merchandise trade deficit with Brazil. In the first eight months of 2008, this trade deficit grew 20% y-o-y to US$ 3.4 billion, in stark contrast to Argentina's agricultural commodity-driven global trade surplus, which totaled nearly US$ 11.1 billion in 2007 and US$ 5.1 billion in the first half of 2008. In 2007, Argentina sent 19% of

its merchandise exports to Brazil and received 32% of its imports from Brazil. The enormous growth in Argentine imports of Brazilian manufactured goods speaks volumes about the relative lack of competitiveness of Argentina's manufacturing sector.)

¶12. (SBU) Budget Management: The GoA will continue its policy of approving select public utility tariff adjustments to limit the growth of subsidies (which currently total roughly 3% of GDP), particularly in the energy and transportation sectors. The focus, Abeles confirmed, will be on tilting such increases to large wholesale users to limit the (immediate) impact on consumers and, as importantly, on the GoA's current CPI measure which remains heavily weighted to the primary consumption basket of low-income earners. In addition, Abeles said, the GoA will selectively slow or defer non-politically sensitive capital infrastructure projects to maintain the primary fiscal surplus in the 3.3-3.4% range (vs. the 3.15% surplus in the 2008 budget and the 3.27% projected in the 2009 budget.)

¶13. (C) Debt Management: The GoA will press ahead on the joint "refinancing" of bond holdout debt and guaranteed loans (BsAs 1320) that would bring in new cash to finance 2009 debt maturities (current estimates are in the range of US$2 to $2.5 billion depending on bond "holdout" participation). IDB President Luis Alberto Moreno (protect), in an October 7 meeting with Ambassador, reported that Economy Minister Carlos Fernandez had confirmed to him earlier market reports that a significant 50% of bond holdouts were ready to tender their debt in the re-financing program. Separately, Secretary Abeles could not confirm persistent market rumors that Finance Secretariat officials are considering negotiating a longer term payment of US $7-odd billion in Paris Club arrears to conserve free reserves during this period of market instability.

Comment

¶14. (SBU) At her New York UNGA-margin Council of the Americas lunch in September, CFK responded with calculated irony when asked whether Argentina had developed an economic contingency "Plan B" in response to rapidly declining commodity prices and gathering international market storm clouds. "You (i.e., developed economies) seem to be the ones who need a Plan B," she said. Yet faced with declining real GDP growth rates, continued pressure on fiscal accounts, and falling commodity prices, the CFK administration appears to be pulling together just such a Plan B to adjust economic policies to current realities. This is welcome pragmatism.

WAYNE